

KEPPEL OPP'N EXH. 38



OSX Brasil S.A. (OSXB3)

Rating	OUTPERFORM* [V]
Price (09 Feb 12, R\$)	14.79
Target price (R\$)	36.00*
52-week price range	21.28 - 11.00
Market cap. (R\$ m)	4,149.71
Enterprise value (US\$ m)	2,770.72

*Stock ratings are relative to the relevant country benchmark.

*Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

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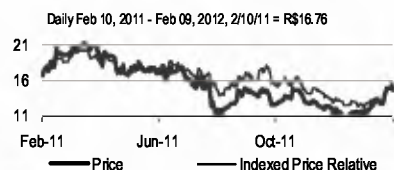
COMMENT

The Sete Brasil surprise?

- **Going for third-party orders with Sete.** After Petrobras announced Friday the orders for the 21 drilling rigs with Sete Brasil and 5 with Ocean Rig, Reuters/Brasi Energia are mentioning Sete is on very final negotiations with the shipyards that will construct the rigs, with OSX's shipyard in a position to win two drillships. We continue to play the backlog growth theme in OSX's cheap valuation, keeping in mind a sweet-spot in execution risk profile.
- **Backlog growth vs execution risk** is a discussion that we think will naturally arise given OSX's shipyard is still in construction. This effectively can be the difference between value creation and destruction. If all the two-\$800m drillships are executed in time (around four years) and OSX achieves a 10% margin, we estimate the orders could add up to R\$0.38/sh. However, it only takes a 12% cost-overrun for the contracts to destroy value, which is not uncommon in the oil industry. At the same time, there is an argument to be made that a \$800m/rig cost that is 30% higher than international benchmarks already incorporates the risks of building in Brazil. In any case, equity markets have historically tended to pay for backlog growth up to the point where execution issues surface. And in construction, risks typically tend to arise in the last third on the contract, which in this case would be 2014. Therefore we think there is an attractive risk-reward to play the growth theme in OSX, even if one is more skeptical view on execution.
- **Who will pay the bill?** This is a relevant question in our view, as Petrobras will pay Sete Brasil a dayrate of \$530k/day, in line with international levels. At the same time, a construction cost of \$800m (based on two recent orders to Keppel and Sembcorp Marine) that is 30% above international level means that the returns will likely not be adequate somewhere in the chain. There is a \$3.0bn shipbuilding guarantee fund in the Sete Brasil structure, which we think will serve as a cushion for this imbalance.

We provide a simple cash-flow valuation for the drillships, sensitivities, and more background on Sete in this note. For more detail on FPSO and shipyard risk profile, please see our note: [OSX – Less risk, more reward](#).

Share price performance



On 02/09/12 the SAO PAULO SE BOVESPA INDEX closed at 64288.01

Quarterly EPS	Q1	Q2	Q3	Q4
2010A	—	—	—	—
2011E	—	—	—	—

Financial and valuation metrics

Year	12/10A	12/11E	12/12E	12/13E
Revenue (US\$ m)	5.0	—	110.8	206.8
EBITDA (US\$ m)	-97.8	-60.0	19.0	96.6
EBIT (US\$ m)	-97.8	-60.0	-1.9	67.7
Net income (US\$ m)	-43.9	46.2	56.3	31.1
EPS (CS adj.) (US\$)	-0.16	0.16	0.20	0.11
Dividend yield (%)	—	—	—	—
P/E (x)	-55.0	52.2	42.9	77.6
EV/EBITDA	-15.8	-46.2	228.5	56.2
P/B (x)	1.7	1.6	1.6	0.9
ROE stated - return on equity	—	3.2	3.7	1.4
ROIC (%)	—	-4.89	-0.07	0.64
Net debt (US\$ m)	-875	352	1,924	3,013
Net debt/equity (12/11E, %)	-59.7	23.3	123.1	106.9
Capex (US\$ m)	-229	-1,272	-1,645	-2,400

Source: Company data, Credit Suisse estimates.

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The Sete Brasil surprise?

After Petrobras announced Friday the orders for the 21 drilling rigs with Sete Brasil and 5 with Ocean Rig, Reuters and Brasil Energia are mentioning that Sete is already in very final negotiations with the shipyards that will construct the rigs, with OSX's shipyard in a position to win two drillships. Other shipyards mentioned by Reuters include KeppelFels, Rio Grande 2, Jurong Aracruz and Enseada do Paraguacu. Sete is expected to sign the contracts with the shipyards within the next week.

Backlog growth vs execution risk is a discussion that we think will naturally arise given OSX's shipyard is still in construction. This in effect can be the difference between value creation and destruction. If all the two-\$800m drillships are executed in time (around four years) and OSX achieves a 10% margin, we think the orders could add up to R\$0.38/sh (Exhibit 1). We think it is conservatively appropriate to use 10% margin as a base case, even if below OSX's 15% target, given this is the ballpark margin level the Singaporean shipyards are aiming for in their projects in Brazil.

Exhibit 1: OSX NPV model for one drillship

Sete Brasil drillship model

Price	USDm	800	Tax rate	34%
Margin	%	10%	Hyundai	10%
Cost	USDm	720	FX	1.7
Cost overruns	%	0%	Shares	280
Real margin	%	10%	Diluted	333
Delivery	years	4		

Year		2012	2013	2014	2015
Revenues	USDm	200	200	200	200
EBITDA	USDm	20	20	20	20
Tax	USDm	(7)	(7)	(7)	(7)
Free cash	USDm	13	13	13	13
Hyundai stake	USDm	(1)	(1)	(1)	(1)
OSX stake	USDm	12	12	12	12
OSX NPV	USDm	38			
OSX NPV	BRLm	64			
OSX NPV	BRL/sh	0.23			
OSX NPV	BRL/sh, diluted	0.19			

Source: Company data, Credit Suisse estimates

However, assuming a 10% margin as a base case, it only takes a 12% cost-overrun for the contracts to destroy value, which is not uncommon in the oil industry (Exhibit 2). On the other hand, there is an argument to be made that a \$800m/rig cost that is 30% higher than international benchmarks already incorporates the risks of building in Brazil.

Exhibit 2: Sensitivity to NPV per share (R\$/sh) to costs and delays

		Cost overruns					
		0%	5%	10%	15%	20%	25%
Years to build	4	0.19	0.11	0.02	(0.07)	(0.15)	(0.24)
	5	0.18	0.10	0.02	(0.06)	(0.15)	(0.23)
	6	0.18	0.10	0.02	(0.06)	(0.14)	(0.22)
	7	0.17	0.09	0.02	(0.06)	(0.13)	(0.21)
	8	0.16	0.09	0.02	(0.06)	(0.13)	(0.20)

Source: Credit Suisse estimates

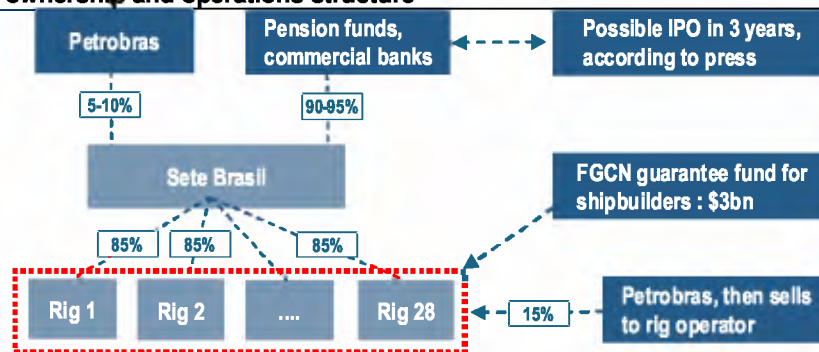
Equity markets have historically tended to pay for backlog growth up to the point where execution issues surface. And in construction, risks typically tend to arise in the last third

on the contract, which in this case would be 2014. Therefore we think there is a good risk-reward to play the growth theme in OSX, even if one is more skeptical view on execution. Two other important aspects of the potential contract with Sete are: (1) in any bidding OSX is targeting for the shipyard to be working capital Neutral, so there should not be any risks relative to working capital needs, and (2) this potential third-party orders will not diminish OSX ability to execute for OGX when it comes to shipyard capacity – drillships will be built in the shipyard's drydock, which will not take any part into the FPSO construction process as OSX will already bring converted hulls from overseas.

Who will pay the bill?

"Who will pay the bill" is a relevant question in our view, as Petrobras will pay Sete Brasil a dayrate of \$530k/day, in line with international levels. At the same time, a construction cost of \$800m (based on two recent orders to Keppel and Sembcorp Marine) that is 30% above international level means that the returns will likely not be adequate somewhere in the chain. There is a \$3.0bn shipbuilding guarantee fund in the Sete Brasil structure, which we think will serve as a cushion for this imbalance. Exhibit 3 provides background on Sete's structure. Sete is a company owned by Petrobras, Brazilian pension funds and commercial banks and was specifically set up to open the market for locally built drilling rigs.

Exhibit 3: Sete Brasil – ownership and operations structure



Source: Credit Suisse research based on various industry sources

The original tender for the rigs started November 2009, for three packages: (i) 7x 10,000ft drillships, (ii) 2x deepwater rigs (semis or drillships) to be owned by Petrobras, and (iii) 19x deepwater rigs to be chartered by PBR. After much delay, EAS, as the sole company tendering, won the contract for the first 7 drillships in February 2011, for a building cost of \$662m and operating dayrates between \$430-475k/day. In October 2011, Petrobras opened the commercial bids for the remaining rigs, with trade press suggesting dayrates of \$605-630k/day by Sete Brasil and Ocean Rig, with rig operators and shipyards associated with each bid (Exhibit 4). Petrobras then went into closed negotiations with both operators to lower down price. OSX did not appear in the supposed shipyard list despite the company being vocal about its participation, which is more evident now after Reuters mentioned a contract with OSX could be signed in a week. Brasil Energia trade press mentioned that OSX's two drillships could also be on top of the 21 awarded Friday.

Exhibit 4: Proposals to Petrobras 21 rig tender

Unity type	# units	Rig company	Rig operator	Shipyard
Drillship	3	Sete Brasil	Odtfell	Jurong
Drillship	3	Sete Brasil	Seadrill	Jurong
Drillship	5	Sete Brasil	Etresco	Enseada do Paraguacu (2) and Rio Grande (3)
Drillship	4	Sete Brasil	Odebrecht	Enseada do Paraguacu
Drillship	5	Ocean Rig	Ocean Rig	Eisa and Maua
Semi-submersible	3	Sete Brasil	Queiroz Galvao	Brasfels
Semi-submersible	2	Sete Brasil	Petroserv	Brasfels
Semi-submersible	1	Sete Brasil	Odebrecht	Brasfels

Source: ODS Petrodata, Brasil Energia

OSX factsheet

Exhibit 5: OSX factsheet

BASICS			
Sector	Oil&Gas/Services	Ticker	OSXB3
Price (R\$)	14.8		
Target (R\$)	36.0		
Recommendation		OUTPERFORM	
Mkt. cap. (R\$ mn)		4,146	
Average daily volume (US\$ mn)		10,870	
SHAREHOLDING STRUCTURE (mn shares)			
	TOTAL		
Centennial Asset Mining Fund LLC.	6,857,189	61%	
Eike Fuhrken Batista	1,964,042	18%	
Management	23,672	0%	
Free float	2,367,697	21%	
TOTAL (mn shares)	11,212,500	100%	

COMPANY DESCRIPTION
OSX is a pre-operational company that aims to supply equipments and services to offshore oil and gas producers in Brazil. It will operate through three business units: Shipyard, Leasing and Operation & Maintenance Services

POSITIVES

US\$ 30 bn potential backlog from agreement with OGX
Hyundai partnership
Strong outlook for offshore equipment in Brazil
Experienced management team

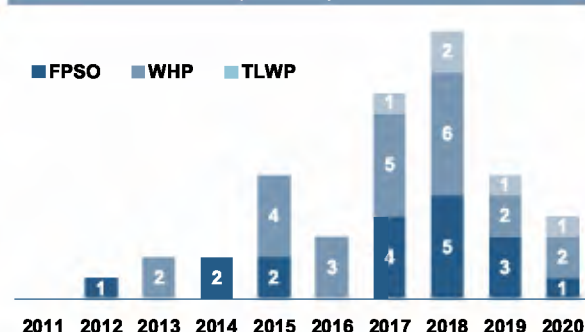
NEGATIVES

Environmental licenses could put business plan timeline at risk
Execution risks
Increasing competition

OSX - MILESTONES (OSX original timeline)

	2010	2011	2012	2013	2014
Environmental licensing		x			
Shipyard construction kick-off		x			
Start-up of FPSO OSX 1		x			
Start-up of shipyard					x
Start-up of FPSO OSX 2				x	
1st shipyard delivery-FPSO OSX 3				x	
Delivery of first WHP built by OSX				x	

EXPECTED DELIVERIES TO OGX (CS schedule)



FINANCIAL METRICS (US\$ mn)	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	111	207	444	860	979	1,779
COGS	(17)	(35)	(73)	(124)	(128)	(236)
Operating expenses	(75)	(75)	(75)	(75)	(75)	(75)
EBIT	(2)	68	174	395	470	917
EBIT margin	-2%	33%	39%	46%	48%	52%
EBITDA	19	97	296	660	775	1,467
EBITDA margin	17%	47%	67%	77%	79%	82%
Net financial result	54	27	19	(108)	(157)	(393)
Taxes	0	(53)	(133)	(194)	(315)	(279)
Net income	56	31	35	57	(61)	193
Net margin	51%	15%	8%	7%	-6%	11%
# shares	280	280	280	280	280	280
EPS (US\$)	0.20	0.11	0.12	0.20	(0.22)	0.69
NOPAT	(1)	45	115	261	311	605
Depreciation	(21)	(29)	(122)	(265)	(305)	(550)
Capex	(1,645)	(2,400)	(3,629)	(4,237)	(6,656)	(5,775)
FCF	(1,626)	(2,115)	(2,947)	(3,106)	(5,185)	(3,762)
Total assets	4,437	7,617	10,818	14,503	20,201	25,016
Cash	857	1,665	1,360	1,073	420	10
Working capital	763	1,545	1,187	864	167	(242)
PP&E	3,500	5,871	9,378	13,349	19,701	24,926
Net debt (cash)	1,924	3,013	5,941	9,155	14,497	18,427
Book value	1,536	2,791	3,317	4,039	5,005	6,299
Market cap.	2,513	2,513	2,513	2,513	2,513	2,513
EV	4,437	5,526	8,453	11,667	17,009	20,940
Invested capital	3,460	5,804	9,258	13,194	19,501	24,726

OPERATING METRIC	2012E	2013E	2014E	2015E	2016E	2017E
Expected units for OGX	1	3	1	6	3	10
FPSOs	1	1	1	2	0	4
WHPs	0	2	0	4	3	5
TLWPs	0	0	0	0	0	1
Expected units for third parties	-	-	-	-	-	-

LEVERAGE	2012E	2013E	2014E	2015E	2016E	2017E
Net debt / Equity	125%	108%	179%	227%	290%	293%
Net Debt / EBITDA	101	31	20	14	19	13
Capex / Operat.Cash Flow	86.6	34.2	16.8	8.4	13.2	4.9

RETURN/YIELD	2012E	2013E	2014E	2015E	2016E	2017E
ROIC	0%	1%	1%	2%	2%	2%
Cost of equity (Ke)	11%	11%	11%	11%	11%	11%
ROE	4%	1%	1%	1%	-1%	3%
FCF Yield	(0.6)	(0.8)	(1.2)	(1.2)	(2.1)	(1.5)

VALUATION	2012E	2013E	2014E	2015E	2016E	2017E
EV / EBITDA	234	57	29	18	22	14
EV / IC	1	1	1	1	1	1
P/E	n.a.	n.a.	n.a.	n.a.	-41	13
P/B	2	1	1	1	1	0

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 10 Feb 12)

Keppel Corporation (KPLM.SI, S\$10.82, OUTPERFORM, TP S\$12.40, UNDERWEIGHT)
 OGX (OGXP3, R\$16.82, RESTRICTED [V])
 OSX Brasil S.A. (OSXB3, R\$14.30, OUTPERFORM [V], TP R\$36.00)
 Petrobras (PBR, \$29.57, NEUTRAL, TP \$34.00)

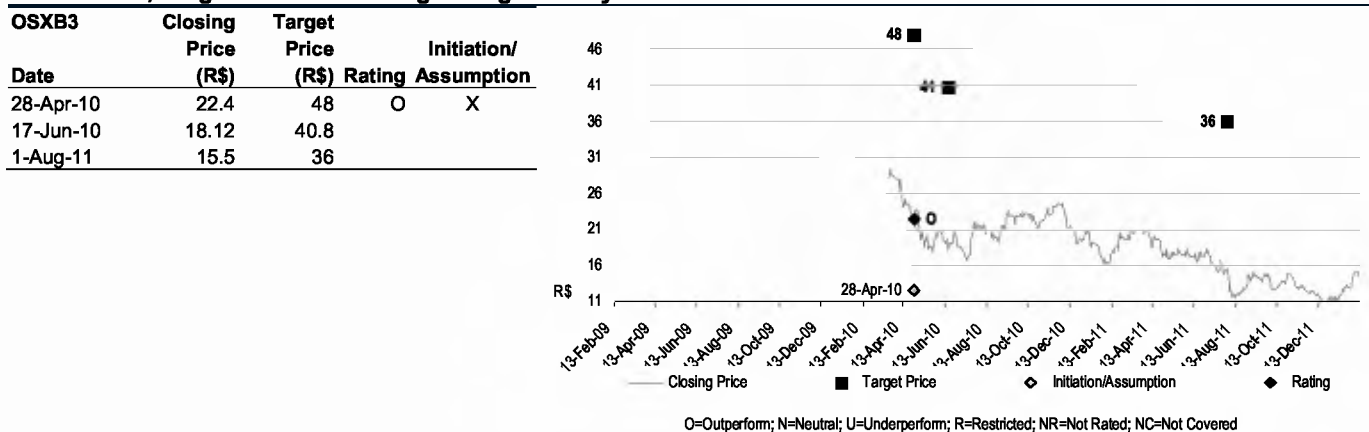
Disclosure Appendix

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3-Year Price, Target Price and Rating Change History Chart for OSXB3



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Price Target: (12 months) for (OSXB3)

Method: Our R\$36/share target price for OSX is based on a DCF (discounted cash flow) model using a Ke (Cost of Equity) of 10% in real terms and no perpetuity.

Risks: Risks to our R\$36/share target price for OSX include (1) non-obtention of environmental license to build its shipyard, (2) exploratory uncertainties which affect demand from OGX, (3) execution of complex business plan, (4) changes in regulatory environment and (5) increase in competition.

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